

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-130818-14

Date:

December 19, 2014

## LEGEND

X =

Date 1 =

Date 2 =

Date 3 =

Period =

State =

Dear :

This responds to a letter signed July 18, 2014, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

## FACTS

According to the information submitted and representations within, X was incorporated on Date 1, under the laws of State. Effective Date 1, X elected to be taxed as an S corporation.

For Period, X made disproportionate distributions to its shareholders. On Date 2, X learned that the distributions it made for Period were not consistent with its governing instruments and could be construed as creating a second class of stock, and, thus,

could potentially have terminated its S corporation election effective the beginning of Period.

X represents that it made disproportionate distributions to its shareholders due to a misunderstanding of the distributions rules by their in-house accountant. Neither X nor its shareholders knew that disproportionate distributions could potentially terminate X's S corporation election. X represents that it relied upon the advice of their in-house accountant.

X represents that it has taken corrective action and on or before Date 3, X made corrective distributions to its shareholders, thus eliminating the cumulative amount of the disproportionate distributions made from X to its shareholders. X represents that neither X nor its shareholders intended to terminate X's Subchapter S election and that X and its shareholders have filed consistently with being an S corporation. In addition, X represents that, other than the potential termination due to a second class of stock, X has qualified as a small business corporation at all times since its election on Date 1. Lastly, X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) of the Code as may be required by the Secretary.

#### LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year. Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, and a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) further provides that the termination shall be effective on and after the date of cessation.

Treas. Reg. § 1.1361-1(l)(1) provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section § 1.1361-1(l)(2)(i) provides, in part, that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state laws, and binding agreements relating to distribution and liquidation

proceeds (collectively, governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing and amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(f) provides in part that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period of inadvertent termination of the S election, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based on the facts submitted and the representations made, we conclude that if the erroneous disproportionate distributions made by X to its shareholders caused X's S corporation election to terminate, the termination was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective the beginning of Period and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d).

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Laura C. Fields

Laura C. Fields

Senior Technician Reviewer, Branch 1

Office of the Associate Chief Counsel

(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes